Admit it. You know you can't do it all on your own. Most of us need help around the house and ultimately wind up employing gardeners to rake our leaves, mow our lawns or clean our gutters. Or we need care-givers for young children, senior adults or other family members and housekeepers to save the day. Unwittingly, we become small-time employers of a team of assistants or, to use the shortcut phrase, we become "household employers." By engaging the services of others to help around the

Help Around the HOU$E

What it could cost you

By Phyllis Horn Epstein

house, a household employer may be required to withhold and report taxes. It is important to be aware of the various reporting requirements to the IRS and Social Security and avoid the significant penalties for noncompliance.

Failing to withhold properly can result in liability for back taxes and for civil and criminal penalties. Employment taxes, particularly those that are withheld from an employee's wages, are considered trust-fund taxes. These are funds held by the employer in trust for the employee, with the expectation that they will be paid to the government. This relationship of trust gives rise to fiduciary responsibilities — and liability for failure to pay.

Many high-profile careers have been derailed because of the failure to withhold employment taxes, including Zoe Baird, nominee to become U.S. attorney general, and Bernard Kerik, former New York City police commissioner and nominee to head the U.S. Department of Homeland Security.

Are you an employer?

Engaging the services of others for work in the home may or may not create an employer relationship. In the alternative, the plumber you hire or the landscaper who cuts your lawn is simply an independent contractor. The Internal Revenue Code tells us that an employer/employee relationship exists where you have "the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished."

Several common-law factors have been developed by the courts that shed some additional light on how the relationship will be regarded. And while no single factor is controlling, the critical factors fall into three general tests.

First, the behavioral control test: The more control you have over how a worker performs his or her work, the more likely the person is an employee. Behavioral control is demonstrated by directing when and where to work, what tools and equipment to use, what assistants may be hired, where to purchase supplies or other services, what work must be performed by the individual rather than delegated, what order or sequence of work to follow and the level of training provided by the employer to do the job.

Second is the financial control test. The more control over the business relationship, the more likely an employer/employee relationship exists. Specifically, the courts will look to whether the worker owns and uses his or her own equipment, whether the person is paid a regular wage, whether he or she can realize a profit or loss and whether his or her expenses are reimbursed.

Third is the relationship test. The existence of a written contract describing the working relationship, the permanency of the relationship and the provision of work benefits may have some bearing. However, a written contract as an independent contractor will not prevail if the relationship is in actuality an employer/employee relationship.

So, for example, Nancy comes to your home five days a week to care for your infant and does light housework. You provide all equipment and supplies she might need and give her specific instructions. Nancy is an employee. But if you take your child to Nancy's home five days a week for child care, Nancy is not your employee.

In another example, Matt mows your lawn on Thursdays. He works for Matt's Garden Care. Matt brings his own lawnmower and hires his own workers. Matt is not your employee.

And in a third example, Busy Bee Service Agency arranges for Roberta to attend to your elderly parent in his or her home at your request. You pay Roberta directly. Roberta is your employee.

If you conclude that your worker is an employee rather than an independent contractor, you must then determine whether employment taxes are required to be paid and how to pay them.

Tax Reporting Requirements

There are three taxes that the household employer should be aware of: income tax, FICA and FUTA.

A household employer is not required to withhold income tax unless an employee specifically makes that request. If the employer is going to withhold income tax, the employee must complete a Form W-4, Employee's Withholding Allowance Certificate, with all of the identifying information.

Federal Insurance Contributions Act (FICA)

The FICA tax encompasses Social Security (old-age, survivor and disability insurance) and Medicare (hospital insurance) covering old-age, survivors' and disability benefits for individuals and families. These are withheld, with certain exceptions.

No withholding is required if a child-care provider is under age 18 and child care isn't his or her principal occupation. This exempts high school students who babysit occasionally. Do not count wages paid to your spouse, to your child under age 21 or to your parent. There was a pay level threshold of $1,900 in 2015 before the FICA tax was due. However, if payments exceeded $1,900, even by $1, then *all* payments were subject to FICA. (2016 levels were not yet set when this article was written.) For purposes of determining this threshold, household employers should exclude the value of food and lodging provided by the employer unless employees are reimbursed for these items with cash. Excluded in 2015 were transit passes provided to commute to your home up to $130/month or paid parking up to $250/month.

Currently the household employer and employee each owe an amount of FICA tax equal to 7.65 percent of wages (6.2 percent for Social Security and 1.45 percent for Medicare). There is no Social Security tax above the "ceiling" amount. That amount in 2015 was $118,500. There is no similar ceiling on the Medicare tax.

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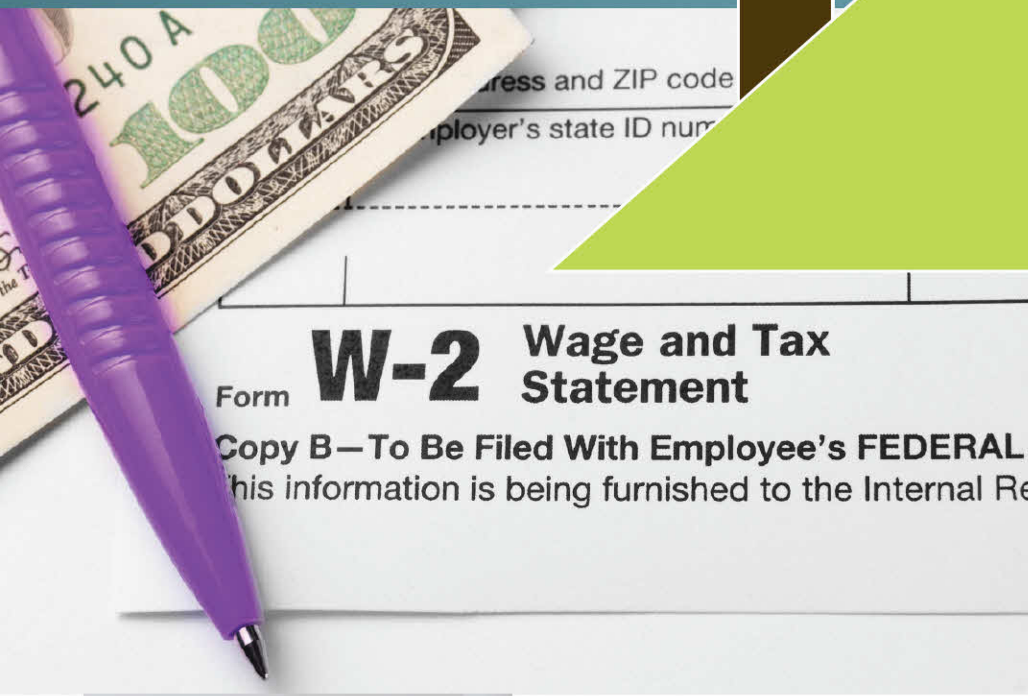

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An additional Medicare tax of 0.9 percent is imposed on wages that exceed $250,000 for joint filers, $125,000 for married individuals filing separately and $200,000 for individuals. This additional tax is imposed only on the employee and not the employer.

If the household employer assumes the cost of the employee's share of FICA tax, the amount paid on behalf of the employee is included as part of employee's wages on Form W-2. The additional amount is not itself subject to FICA or FUTA.

Federal Unemployment Tax Act (FUTA)

Unemployment taxes are paid at both federal and state levels. An employee who works off the books forfeits the chance to collect unemployment if out of work. As with FICA taxes, there are exceptions with FUTA taxes. However, bear in mind that these federal exceptions may not preclude you from having to pay state unemployment taxes.

Do not count wages paid to your spouse, your child under age 21 or your parent. In 2015, FUTA tax was required only if you paid total cash wages of $1,000 or more in any calendar quarter.

The FUTA tax is 6 percent of an employee's FUTA-paid wages up to $7,000. This is *not* a withheld tax and the cost is charged 100 percent to the employer. Amounts (or a portion thereof) paid to state unemployment by April 15 of the following year are credited against the federal liability, which may result in a net federal rate of only 0.6 percent. If the employer's FUTA obligation for the year is going to be greater than $500, then the employer must make quarterly deposits.

In summary, the household employer and household employee are each responsible for the following employment taxes:

- Employer payments: 6.2 percent Social Security tax, up to $118,500 (maximum tax is $7,347); 1.45 percent Medicare tax, unlimited; and 6 percent FUTA tax, up to $7,000, and this is *not* a withheld tax and the cost is charged 100 percent to the employer.

• Employee payments: 6.2 percent Social Security tax, up to $118,500 (maximum tax is $7,347); 1.45 percent Medicare tax on first $200,000 of wages; and 2.35 percent Medicare tax on wages of more than $200,000 (1.45 percent plus 0.9 percent).

How to File and Pay Tax

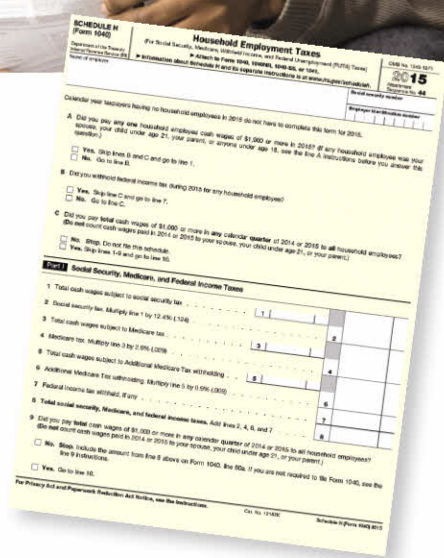
Assuming wages were paid in 2015 and household employment taxes are due, follow these steps:

1. Apply no later than Feb. 1, 2016, for a new tax EIN (Employer Identification Number) for employment-tax purposes for all reporting of wages and withholding.

2. Prepare a Form W-2 for each employee and give each employee copies B, C and 2 no later than Feb. 1, 2016, for wages paid in 2015. Send Copy A of the Form W-2 with a Form W-3, Transmittal of Wage and Tax Statements, to the Social Security Administration by Feb. 29, 2016. (Yes, it's a leap year.)

3. Household employers may be required to inform their employees about the earned income credit, which will allow them to obtain a tax refund if they meet certain income limits. The IRS encourages employers to give this notice to employees who earn less than $47,747 ($53,267 for joint filers) even if no tax will be due. This information can be communicated in several ways.

- Give the employee Copy B of Form W-2. The earned income credit information appears on the back.
- Provide an employee with a substitute of Copy B.
- Provide a copy of Notice 797, Possible Federal Tax Refund Due to the Earned Income Credit.
- Provide a personal notice with the same substantive information.


SCHEDULE H (Form 1040)
Household Employment Taxes
2015

4. Each household employer should file Schedule H with his or her individual tax return before the due date. If no tax return will be required, a Schedule H can be filed independently. Regular business employment tax returns such as Form 941, Employer's Quarterly Federal Tax Return, are not required.

5. A household employer may pay the tax by either (1) increasing quarterly estimated tax payments or (2) increasing personal withholding. By failing to pay enough estimated tax, a household employer can be subject to penalties.

The more control over the business relationship, the more likely an employer/employee relationship exists.

Record Keeping

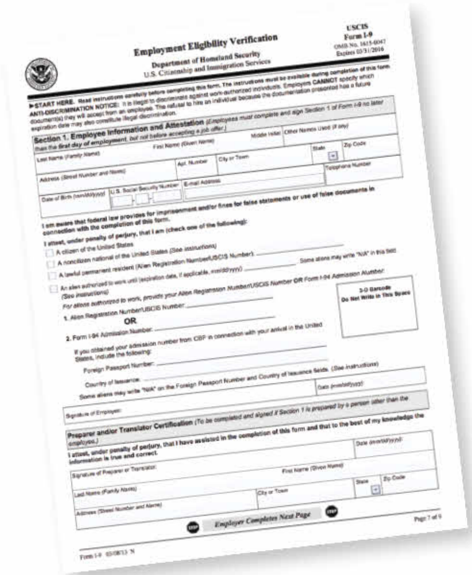
The Internal Revenue Code regulations require that employers (and employees) maintain employment tax records for a period of four years commencing from the later of the due date of the employee's return showing those wages or the payment of tax. The Social Security Administration and the IRS recommend that the following records be maintained:

- Employer Identification Number (EIN);
- Employee's name, address, occupation and Social Security number;
- Total amount and date of each payment of compensation and amounts withheld for taxes or otherwise, including reported tips and the fair market value of non-cash payments;
- Amount of compensation subject to withholding for federal income, Social Security and Medicare taxes and the corresponding amount withheld for each tax (and the date withheld if withholding occurred on a different day than the payment date);
- Pay period covered by each payment of compensation;
- Where applicable, the reason(s) why total compensation and taxable amount for each tax rate are different;
- Employee's Form W-4;
- Employee's beginning and ending dates of employment;
- Any statements provided by the employee reporting tips received;
- Fringe benefits provided to the employee and any required substantiation;
- Adjustments or settlements of taxes; and
- Amounts and dates of tax deposits.

Other Responsibilities

As the employer, it is also your responsibility to be certain that your employee is either a U.S. citizen or has the legal right to work in the United States. Each employee should complete a Form I-9, Employment Eligibility Verification, which will confirm his or her legal status. You can obtain Form I-9 at the website of the U.S. Citizenship and Immigration Services, www.uscis.gov, or by calling 800-375-5283.

You may be required to pay overtime for the employment of domestic service workers. The U.S. Department of Labor defines these workers as those who provide services "of a household nature in or about a private home." The list of domestic serv-



ice workers is replete with synonyms but gives a rather thorough sense of who is covered by this general term: companions, babysitters, cooks, waiters, maids, housekeepers, nannies, nurses, caretakers, handymen, gardeners, home health aides, personal care aides and family chauffeurs. Live-in domestic service workers are exempt from the requirement of overtime pay but are otherwise required to be paid the federal minimum wage.

Risks

The unlikely risk of audit and the complexity of filing have resulted in a steady decline in the number of Schedule H returns being filed for household employees, in direct contrast to the increased number of child-care workers and home-care aides that are being employed. Studies have shown that those more likely to come under scrutiny are either federal employees or high-profile politicians who seek national office in Washington, D.C. For others it is enough to keep in mind that there is no statute of limitations for failing to file employment taxes and that the cost of paying back taxes, interest and penalties can be very substantial. In addition, there is the potential for personal liability for the injuries of someone who trips over toys in your home if he or she is not covered by workers' compensation insurance. So consider the members of your personal-help team and think about those relationships in a new light. And in the end, ask yourself the question: Am I a household employer?

A written contract as an independent contractor will not prevail if the relationship is in actuality an employer/employee relationship.

Phyllis Horn Epstein is a partner with the Philadelphia law firm of Epstein, Shapiro & Epstein PC, with more than 30 years' experience in taxation, corporate transactions, and trusts and estates. She represents clients before the IRS and the Pennsylvania Department of Revenue and in the U.S. Tax Court and the Orphans' Courts of Pennsylvania. She is a fellow of the American College of Tax Counsel and a recipient a PBA Special Achievement Award for her three years of service as treasurer of the PBA.

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